

STATEMENT¹
OF
PHOEBE MORSE
DIRECTOR
BOSTON REGIONAL OFFICE
FEDERAL TRADE COMMISSION
TO THE
COMMONWEALTH OF MASSACHUSETTS
ALCOHOLIC BEVERAGES CONTROL COMMISSION
JUNE 26, 1996

¹ This statement represents the views of the staff of the Boston Regional Office and the Bureau of Competition of the Federal Trade Commission, and not necessarily the views of the Commission or any individual Commissioner.

Mr. Chairman and Commissioners: I am pleased to present this statement concerning the likely competitive effects of certain regulations found in 204 Code of Massachusetts Regulations ("CMR"). This statement represents the views of the staff of the Boston Regional Office and the Bureau of Competition of the Federal Trade Commission. They are not necessarily the views of the Commission or any individual Commissioner.

The Massachusetts Alcoholic Beverages Control Commission ("MABCC") is considering amending 204 CMR by repealing regulations that require wholesalers of alcoholic beverages to post prices on a monthly basis and to adhere to those posted prices in their sales to retailers during the following month. We believe that repeal of the price posting regulations would increase competition. Our comments address only the competitive effects of price posting requirements and do not address any of the other policies implicated in the marketing of alcoholic beverages.

I. Interest and Experience of the Staff of the Federal Trade Commission.

The Federal Trade Commission is charged by statute with preventing unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.² Under this statutory mandate, the Commission seeks to identify restrictions that impede competition or increase costs without offering countervailing benefits to consumers. The staff of the Commission have had considerable experience assessing the competitive impact of regulations

² Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.

and business practices in the alcoholic beverages industry.³ In providing comments on particular statutes or regulations, we assess their likely effect on competition.

II. Description of the Existing Regulations.

The regulations that are the subject of today's hearing involve the Massachusetts state wholesale pricing system for all alcoholic beverages. Section 6.03 requires wholesalers to file price lists with the MABCC. The list must be filed no later than the fifth day of each month; it becomes effective on the first day of the following month and remains in effect for that month. Wholesalers must also furnish retailers with copies of the price list.

Section 6.04 provides that between the fifth and fifteenth day of the month before the effective date of a filing, a wholesaler may amend its price list to meet a specific lower price or a specific greater discount for any individual item filed by any other wholesaler.

Under Sections 6.03 and 6.04, discounts may be offered only on individual items; that is, a discount that applies to the purchase of a combination of items may not be offered.⁴ Wholesalers may grant discounts based only on the quantities of each item purchased and the time of payment, with limited exceptions.

III. Competitive Effects of 204 CMR.

A. Information Exchange Aspects of Price Posting.

³ See, e.g., Comments to the Bureau of Alcohol, Tobacco and Firearms, July 27, 1994 (suppliers and retailers); Bureau of Alcohol, Tobacco and Firearms, November 15, 1988 ("light" beer); Oregon Liquor Control Commission, March 7, 1988 (price posting); Nevada Legislature, June 12, 1987 (suppliers and wholesalers).

⁴ In general, "item" is defined by statute as a case of product identified by brand or trade name.

The price posting requirements in Sections 6.03 and 6.04 give competitors complete information about one another's present prices and advance notice of competitors' proposed price changes. The regulations also require wholesalers to adhere to their posted prices and make compliance a condition of their licenses.⁵

The availability of comprehensive price information tends to make it easier for industry members to coordinate prices tacitly and to detect and discourage deviation from the consensus price.⁶ See Stigler, G., A Theory of Oligopoly, 72 J. Pol. Econ. 44, 46-48 (1964) ("Enforcement [of a collusive agreement] consists basically of detecting significant deviations from the agreed-upon price. Once detected, the deviations will tend to disappear because they are no longer secret and will be matched by fellow conspirators if they are not withdrawn."). The regulations provide not only information, but potentially an independent enforcement mechanism for any coordinated pricing.

B. The Requirement that Posted Prices Remain in Effect for One Month.

Requiring posted prices to remain in effect for one month may harm competition by deterring price changes. Restrictions on price changes interfere with market signals and are

⁵ Section 6.03 provides that the posting requirements and related regulations "shall be deemed to be a condition of a wholesaler's license to sell alcoholic beverages to a retailer."

⁶ In fully competitive markets, the provision of quick, accurate information generally tends to be procompetitive. Indeed, perfect information is one of the underlying assumptions of the competitive model. But certain markets may not fit the competitive model well even in the absence of price regulation or price posting. They may be conducive to collusion because concentration is high in some segments or because entry is restricted by statute. In such markets, greater information can lead to the results described in the text.

likely to result in higher prices (as in the case of restrictions on price decreases) or reduced output (as in the case of restrictions on price increases).

The regulations prohibit price reductions of less than one month. Short-term price reductions are often important to the efficient functioning of the marketplace. Such flexibility, for example, permits wholesalers to respond quickly to changing supply and demand conditions.

Second, the regulations are likely to deter longer-term price reductions by greatly increasing the attendant risks. In practice, the one-month effective period, coupled with as much as another month's notice, commits sellers to reduced prices for extended periods, regardless of changes in market conditions. In many instances, it may be difficult to forecast supply and demand conditions for such extended periods, and the inability to vary prices quickly in response to changes in those conditions increases the costs of an erroneous pricing decision. By increasing the risks associated with price reductions, the regulations are likely to deter price reductions of all types, resulting in higher prices to consumers.

Third, the regulations have a similar deterrent effect on price increases, which are equally important in a competitive market, where changes in price operate as signals to bring the output of producers (supply) into equilibrium with consumer demand.

C. Permitting Wholesalers to Match Competitors' Prices.

The likely net effect of permitting wholesalers to match competitors' price reductions is to maintain prices at a level higher than they would be in the absence of any price posting restrictions. In general, the greatest profits from price cutting are likely to occur between the time that the cutter offers the reduced price and the time that other wholesalers respond to the

price reduction. Cf. 44 Liquormart, Inc. v. Rhode Island, 116 S. Ct. 1495 (1996) ("prohibition against price advertising, like a collusive agreement among competitors to refrain from such advertising, will tend to mitigate competition and maintain prices at a higher level than would prevail in a completely free market"). Permitting competitors to match a price cut before it goes into effect effectively eliminates this interval, reducing wholesalers' incentives to initiate price cuts and contributing to overall price rigidity.

D. Restrictions on the Types of Discounts that May Be Granted.

The regulations permit discounts based on quantities purchased (both per order and cumulatively) and prompt payment; they also permit wholesalers to grant a pick-up discount, not to exceed one percent, to retailers who pick up product at the wholesaler's warehouse. However, even the permissible discounts are limited: the quantity discount may be granted only on an individual item basis, and the prompt payment discount is limited to payment within 10 days. The regulations appear to prevent granting other discounts, such as incentive discounts in the form of free goods and promotional discounts to obtain a new customer, even when such discount programs could be offered in a manner consistent with applicable price discrimination statutes. The likely effect of these limitations on discounting is higher prices for Massachusetts consumers.

IV. Conclusion.

For these reasons, the staff believes that repeal of the designated provisions of 204 CMR dealing with sales of alcoholic beverages would tend to encourage competition in the sale of alcoholic beverages in Massachusetts.